Moody's Investors Service

New Issue: Maine (State of)

MOODY'S ASSIGNS Aa3 RATING AND STABLE OUTLOOK TO STATE OF MAINE'S $105.9 MILLION GENERAL OBLIGATION BONDS (TAX-EXEMPT) AND $24.8 MILLION GENERAL OBLIGATION BONDS (TAXABLE)

Aa3 RATINGS AFFIRMED ON APPROXIMATELY $453 MILLION OUTSTANDING G.O. DEBT AND A1 RATING ON APPROXIMATELY $193 MILLION LEASE RENTAL BONDS ISSUED THROUGH MAINE GOVERNMENTAL FACILITIES AUTHORITY

State
ME

Moody's Rating

ISSUE		RATING
General Obligation Bonds (Tax-Exempt)		Aa3
Sale Amount	$105,985,000	
Expected Sale Date	06/02/09	
Rating Description	General Obligation	
General Obligation Bonds (Taxable)		Aa3
Sale Amount	$24,830,000	
Expected Sale Date	06/02/09	
Rating Description	General Obligation	

Opinion

NEW YORK, May 27, 2009 -- Moody's Investors Service has assigned a rating of Aa3 with a stable outlook to the State of Maine's upcoming sale of $105.9 million General Obligation Bonds (Tax-Exempt) and $24.8 million General Obligation Bonds (Taxable). Moody's has also affirmed the Aa3 ratings on Maine's $453 million outstanding general obligation bonds and the A1 rating on $193 million in outstanding lease rental bonds issued through the Maine Governmental Facilities Authority. Maine plans to sell the bonds the week of June 1. A portion of the proceeds will be used to retire bond anticipation notes at maturity next month. The notes were issued during the past fiscal year to finance statewide capital expenditures. The state will also use proceeds for a variety of statewide projects.

Maine's financial operations are narrow, with slim cash balances and modest reserve levels. The recession has led to revenue underperformance that challenged the state to resolve a $129 million gap in the 2008-2009 biennial budget and a $440 million shortfall for the upcoming 2010-2011 biennium. The state's overall management strength is underscored by efforts to rebuild balances and control costs while also stepping up state spending on K-12 education as mandated by a citizens' initiative approved in 2004. Growth in service sector employment helped maintain positive job gains in Maine in 2006 and 2007 although the pace of growth trailed the nation. State and national employment was essentially flat in 2008 and monthly year-over-year job losses have accelerated in the first quarter of 2009.

Long-term credit strengths of the state:

*Management of spending levels while absorbing substantial K-12 education costs mandated by citizens' initiative.

*Commitment to improving available reserve levels to enhance financial flexibility.

*Alternative liquidity in treasurer's cash pool eases concerns over narrow General Fund ending cash balances

*Manageable debt ratios (per capita and personal income) and rapid 10-year retirement of principal provide flexibility to shift from pay-go to debt capital financing.

Long-term credit challenges for the state:

*Weak GAAP-basis balance sheet reflecting negative position of state's General Fund unreserved, undesignated balance,

*Depletion of Maine's Budget Stabilization Fund (BSF) to resolve budget gaps leaves fewer options to resolve unexpected shortfalls.

*Liquidity remains narrow due to negative available combined reserve levels.

*Voter initiative activity continues to add an element of fiscal uncertainty.

*Maine's economic growth lags the national pace and weak employment prospects hinder Maine's revenue performance.

SIZEABLE $569 MILLION COMBINED BUDGET GAP FOR FISCAL 2009 AND UPCOMING 2010-2011 BIENNIUM

Maine's revenues have been hurt by the national economic downturn, as they have been in nearly every other state. Moody's assigned a negative outlook to the U.S. state sector in February 2008 and affirmed that negative outlook this past February. The legislature is currently reviewing a budget plan, essentially as proposed by the governor, which was unanimously adopted by the Legislature's Appropriation's Committee. That plan addressed a current fiscal year (2009) gap of $129 million as well as a $440 million shortfall for the upcoming 2010-2011 biennium. With less than two months before the end of the state's fiscal year, the plan relies on one-time measures to close the gap for fiscal 2009: $92 million from the state's budget stabilization (BSF) and working capital funds, and $35 million from federal fiscal stimulus funds, including stabilization and additional Medicaid (FMAP) funds. The remaining $24 million in the BSF will be used in fiscal 2010, and the budget solution incorporates approximately $97 million in additional federal stimulus funds over the next two fiscal years. Spending reductions account for the remaining portion of the governor's gap-closing plan, including cuts to higher education, social services, and elsewhere in state government. There will be ten state government shutdown days each year and state employees will be required to pay a portion of their health insurance. Federal stabilization money will help the state fund K-12 education at $1 billion in fiscal 2010, up from $983 million in fiscal 2009. This allows school districts time to plan for reduced state education funding ($947 million) in fiscal 2011.

The governor's original budget plan presented in January reduced General Fund spending from $6.3 billion in the 2008-09 biennial budget to $6.1 billion for 2010-2011. The revised plan reduces expenses further to $5.8 billion in the 2010-2011 biennium. While Maine has a funding mechanism to refill its BSF from surplus money at fiscal yearend, the state's financial operations are expected to remain tight over the next two years, with little margin for rebuilding the BSF in the near term. As in many states, Maine's federal stimulus funds are being used to fill budget gaps that are due to the current recession. The state's ability to plan for the eventual falloff in additional federal money and restore structural budget balance will be an important credit consideration.

STATE AVOIDED CASH FLOW BORROWING IN LAST THREE FISCAL YEARS; BALANCE SHEET REMAINS WEAK

Maine's year-end cash position remains slim, although fiscal year 2009 marks the third consecutive year that the state was able to avoid the issuance of tax anticipation notes for cash flow purposes. Prior to the recession, the state was able to improve its overall liquidity trends through concerted efforts to hold down expenditure growth, aided by conservative revenue forecasts. Given the recent revenue deterioration and likely near-term depletion of rainy day funds, Maine plans to return to cash flow borrowing in fiscal 2010.

Maine's originally adopted budget for the fiscal 2008-2009 biennium closed a structural gap of $570 million, continuing a downward trend from the $733 million gap the state faced in the fiscal 2006-2007 biennium and $1.2 billion prior to that. The state has balanced its budgets in recent years, including the 2008-2009 budget, largely by controlling expenditure growth. At the same time, Maine has increased its spending for K-12 education pursuant to a citizens' initiative that requires an increase in state public education funding from its prior level of 49% to 55%, thus providing some property tax relief at the local level.

Audited results show that Maine ended fiscal year 2008 with an operating deficit of $73.7 million. The Budget Stabilization Fund (BSF) increased to approximately $129 million, about 4% of general fund revenues. However, the unreserved undesignated General Fund balance was a negative $533 million that is largely the result of several accounting changes in recent years as well as recognition of the state's share of Medicaid liabilities at fiscal year end. The net effect of these changes resulted in negative year-end unreserved General Fund balances (UUFB) beginning in fiscal 2006. Positive amounts designated for the BSF are incorporated into the total. At the end of fiscal year 2008, Maine's available reserve position was significantly negative at 16.3% of General Fund revenues.

Despite the state's negative unreserved General Fund balance position, the amount designated for the BSF has increased in recent years, a notable achievement following the depletion of reserves after the 2001 recession. Still, Maine's GAAP-basis balance sheet will likely remain weak relative to more highly rated states, reflecting the state's earlier multi-year period of structural budget imbalance, draws on reserves to address revenue shortfalls, continuing education and Medicaid cost pressures, and the continuing revenue shortfalls that increase the state's out-year budget gaps.

MAINE'S ECONOMIC GROWTH SLOWS

Maine emerged relatively early from the 2001 recession, recovering all of the jobs lost by mid-2004. Since then, the state's labor statistics have maintained some upward momentum but lagged the national pace of job growth. Maine's total non-farm monthly employment was essentially flat year-over-year in 2008. The state's education and health as well as leisure and hospitality service sectors continue to gain jobs, and these have helped offset further declines in manufacturing, primarily in paper and textile goods largely reflecting worldwide competition in those industries. In light of the national recession, prospects for Maine's economy appear modest over the near term, as is true for many states. Maine's unemployment rate rose to 8.1% in March 2009, slightly below the national rate of 8.5% the same month.

MANAGEABLE DEBT RATIOS AND RAPID PAYOUT

Maine continues its conservative approach to debt, with an aggressive payout structure and capacity to accommodate unforeseen borrowing needs. Below-average debt levels are in part due to the state's general practice of using available cash rather than new debt to fund approximately 50% of annual capital expenditures, providing additional flexibility to shift to borrowing during periods of economic stress leading to revenue underperformance. General obligation debt amortization is scheduled for a rapid but still affordable 10-year payout, shorter than in most other states. Maine has no exposure to variable rate debt or swaps.

At the end of calendar year 2008, Maine had approximately $978 million in outstanding net tax-supported debt, all fixed rate, and gross debt equaled about $5.1 billion, reflecting a large amount of debt supported by a state moral obligation pledge. Maine's debt ratios for 2008, based on 2007 debt levels, were below average. The state's net tax-supported debt was 1.9% of total state personal income, lower than Moody's 2008 50-state debt median of 2.6%. Net tax-supported debt equaled $618 per capita, also below our 2008 state debt median of $889.

Maine's total fixed costs, including pension as well as debt service requirements were approximately 9% of operating expenditures in fiscal year 2008. In fiscal years 2002 through 2006, the state made additional contributions above the annual required contribution. These, in combination with improved market results, raised the state's funding levels to 80% as of June 30, 2008. As in many states, significant losses in the equity markets due to the recent market turmoil will likely be reflected in reduced pension funding levels over the near term although Maine's ratios are somewhat below average to begin with.

Maine pays varying portions of post-retirement health insurance and premium costs for retired employees, depending on the date of retirement, length of service, and Medicare eligibility. The state's most recent OPEB analysis shows an unfunded actuarial accrued liability of approximately $1.2 billion as of January 2009. At the end of fiscal year 2007, the state deposited $100 million into a trust for the OPEB obligation, resulting in a lower overall liability. The annual required contribution was $157 million in fiscal year 2008 and the state contributed $184 million. The state plans to fund its OPEB obligations on a pay-go basis for now.

MOST RECENT RATING ACTION AND PRINCIPAL METHODOLOGY

The last rating action with respect to the State of Maine was on August 6, 2008, when the rating of MIG 1 was assigned to the State of Maine General Obligation Bond Anticipation Notes, Tax-Exempt and Taxable.

The principal methodology used in rating the current issue was "Moody's State Rating Methodology," which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

Outlook

The credit outlook for Maine's long-term obligations is stable, reflecting Moody's expectation that the state will manage its budget challenges and make appropriate adjustments as needed to restore budget balance in the event that the economic downturn is greater than expected resulting in weaker than projected revenues. The state has demonstrated its ability to address budget shortfalls in recent years, with minimal reliance on one-time solutions, and remains committed to improving the state's reserves, holding expenditure growth, and improving its cash position. Reliance on one-time budget solutions is understandable during the current recessionary period. Continuing and/or increased use of non-recurring measures to resolve budget shortfalls would pose credit concerns.

What would it take for rating to move up?

*Achievement and maintenance of higher GAAP-basis combined available reserve levels.

*Established trend of structural budget balance.

*Evidence of stronger economic performance.

*Improved General Fund cash margins.

*Institutionalized best financial management practices consistent with more highly rated credits.

What would it take for rating to move down?

*Further revenue weakness driven by delayed economic recovery.

*Cash flow strain stemming from reduced liquidity

*Economic weakening leading to employment erosion and revenue loss.

*Increased use of non-recurring solutions to balance budget creating persistent structural imbalance.

*Failure to adopt plan to cover expenditures once federal fiscal stimulus monies are no longer available

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